A rule to catch them all

How European policies on combating abuse of rights in tax law aim at countering cynicism by non-state actors

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One of the legal regimes where cynicism is most prevalent in the eye of the public is tax law. After the so-called 'Panama Papers' and 'Paradise Papers' public debate on fair taxation of companies was rekindled at the World Economic Forum 2019, where Rutger Bregman stressed that it is cynical when people talk about philanthropic engagement, equality and transparency, yet 'almost no one raises the real issue of tax avoidance'. The EU *does* raise this issue – yet the devil regarding the development of a European policy on combating the abuse of rights in tax law lies, as I will demonstrate, in the details: the concrete criteria of general anti-abuse rules (GAAR). After examining the two contrasting lines of jurisprudence by the European Court of Justice (ECJ) in this respect, I will show why the better arguments speak for adopting the broader notion of abuse.

With regard to the inconsistent use of terminology (abuse, misuse, circumvention, evasion,…), by 'abuse of a right' I mean hereafter a teleological misapplication of a right, while at the same time formally fulfilling its constituent elements. Broadly speaking, the (mis)conduct is – in contrast to tax evasion – not punishable by law, but the adopted arrangement is impermissible and not recognised for tax purposes. If cynicism is merely understood as indecent behaviour, then both tax evasion and the abuse of laws can be characterized as cynical. If cynicism is defined as actions that ultimately could lead to a hollowing of the law, then only abusive actions would fall under this definition. Abuse (in tax law) is characterized by the meticulous adherence to the wording of a provision, yet at the same time its objective is frustrated – the law is essentially used as a tool against itself.

As tax law in particular attracts aggressive legal forms with a high intensity, tackling each arrangement separately would be cumbersome and not effective enough. Therefore general (catch-all) clauses are necessary. A GAAR, however, should respect the right of the tax subject to choose the most favourable tax form between several (permissible) forms of design as was recognized not only by the ECJ but also by the EU legislator (Recital 11 of the Anti-Tax-Avoidance-Directive, ATAD). Furthermore, such a rule should be certain and foreseeable. A proliferating GAAR would also run the risk of constituting an obstacle to the internal market.

The ECJ's Two Lines of Jurisdiction on 'Abuse': *Cadbury* versus *Halifax*

The ECJ has already confirmed a general legal prohibition of abuse, yet it has not prescribed a normative standard for assessment in the form of lying down specific

criteria as to when abuse of rights is to be presumed. But in two practically relevant case groups, certain criteria are emerging in its jurisprudence: (1) the justification for an encroachment on the fundamental freedoms by a national tax burdening measure and (2) the justification for the refusal of a tax advantage granted under EU secondary law.

In the first group, especially regarding Art 49 (right of establishment) and Art 63 TFEU (free movement of capital), the ECJ departs from a narrow understanding of abuse, the *Cadbury*-criteria. An encroachment on fundamental freedoms by a national tax burdening measure is justified when:

- there is a wholly artificial design,
- the fundamental freedom is formally applicable, but its original objective is frustrated and
- the tax subject strives exclusively for a tax advantage.

In the second group the ECJ follows instead a broad understanding of abuse, the *Halifax*–criteria, stating that a tax advantage can be refused by a member state when:

- the scope of the EU secondary law is formally opened, but
- the tax advantage granted is incompatible with the *ratio legis* of said secondary law and
- essentially [not exclusively] a tax advantage is intended.

These two different abuse standards lead to legal uncertainty for the taxpayer and the risk of being interpreted inconsistently by the authorities. The narrow *Cadbury*-criteria would be supported by the fact that they are easier to manage and more precise and thus more likely to protect the rights of the taxable person. The *Halifax*-criteria on the other hand are more flexible and give the EU and member states greater room for action to combat cynicism in tax law. However, it bears the risk that the ECJ and the member states could – using the pretext of abuse of rights – indirectly restrict the scope of Union law.

The case for *Halifax,* or for a broad notion of 'abuse'

EU secondary legislation such as Article 6 ATAD now provides for an explicit GAAR that follows the *Halifax*-criteria. This raises the question against which standard a national measure based on Art. 6 ATAD and accused of encroaching on fundamental freedoms should be examined, or basically of the relationship between the two lines of judicature. In the *Eqiom*–case, the ECJ had to answer this question but did so in an unsatisfactory manner: After a cursory examination and without justification, the Court held that both case groups had the same scope, namely that of the narrow *Cadbury*-criteria. Such an assessment ignores, however, that the legislator has shown a clear will not to follow the narrow *Cadbury*-criteria in Art. 6 ATAD by deviating from the artificiality criterion. Neither should Art. 6 ATAD be teleologically reduced, especially following its unanimous adoption by the Council pursuant to Art. 115 TFEU. Nor can it be argued, that by passing Art. 6 ATAD, the EU legislator has exceeded his competence. It is undisputed that secondary

legal acts such as Art. 6 ATAD are not the right instrument to (indirectly) restrict the scope of application of the fundamental freedoms e.g. by establishing new grounds for justification. Here, however, a mere clarification of an pre-existing ground for justification was made (which the ECJ itself represents in part). Furthermore, since the (strict) proportionality test inherent in Union law is applicable not only in the area of fundamental freedoms but also to GAAR enshrined in secondary Union law, adequate protection of corporations and other tax subjects is ensured. In light of Art. 6 ATAD, broad abuse criteria should therefore be given priority.

However, a broad abuse concept consisting of Art 6 ATAD / the *Halifax*-criteria also needs to be interpreted further. In two preliminary ruling proceedings in the beginning of 2019, the ECJ started listing concrete indicators pointing to abuse, such as mere conduit companies or pro-forma groups of companies. Another potential source for such indicators is the recent Council directive DAC 6 regulating the exchange of information in the field of taxation. It introduces a new way of detecting abusive practices: a notification requirement for intermediaries (or tax subjects) to file 'information that is within their knowledge, possession or control' on certain arrangements (Art. 8 ab). The obligation to report applies to cross-border arrangements that display one of the so-called 'hallmarks' listed in Annex IV. Those hallmarks, e.g. double deductions for the same depreciation on the asset, are indications for a 'potential risk of tax avoidance' (Art 3 (20) DAC 6). They could also guide the interpretation of the above-mentioned abuse concept. However, the different objectives of ATAD and DAC 6 – tackling actual tax avoidance vs. transparency about potentially aggressive arrangements – must be taken into account, so that a non-notifiable structure will not automatically be eligible for tax recognition and vice versa.

At a European level the most important problem lies within the theoretical assessment of cynicism in tax law and the development of practicable abuse criteria. Article 6 ATAD makes an essential contribution to this: The (broad) *Halifax*-criteria of the ECJ, which are basically codified in Art 6 ATAD, have the potential to modify the standard of abuse assessment beyond the scope of the Directive in the long term. A demand to abandon the narrow *Cadbury*-criteria was once again made clear recently in connection with the Mobility-Directive. It remains to be seen whether the ECJ will finally drop them. Since (Art. 6 of) the ATAD was already adopted (but not yet applicable) at the time of the *Eqiom-c*ase, it is unlikely that the ECJ will reverse the trend, though. To the contrary, a vague blending of both standards, as proposed by Advocate General Kokott, seems more likely.

The EU is working sedulously on the development of a general anti-abuse concept. Combatting the abuse of rights in tax law is not a specific feature of European law – the OECD has already addressed this issue. The cross-border fight against abuse of rights, though, quickly finds its limits in the national fiscal sovereignty of individual states. As sovereignty within a supranational organisation is already loosened per se, the EU may presumably be able to proceed more efficiently than an international organization like the OECD.

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